Comments of the California Independent Petroleum Association on the Second Fifteen Day Changes to the Cap and Trade Rule

The California Independent Petroleum Association (CIPA) appreciates the opportunity to submit the following comments to the California Air Resources Board (CARB) for its consideration.

The mission of CIPA is to promote greater understanding and awareness of the unique nature of California's independent oil and natural gas producer and the market place in which he or she operates; highlight the economic contributions made by California independents to local, state and national economies; foster the efficient utilization of California's petroleum resources; promote a balanced approach to resource development and environmental protection and improve business conditions for members of our industry.

The members of CIPA believe that domestic petroleum production already plays a meaningful role in helping the state meet its policy goals for reducing greenhouse gas emissions in California. But we are deeply concerned that the current climate policy construct could lead to widespread curtailment of domestic production, which in turn will lead to increased use of imported crude feedstocks and the transportation necessary for the imports- crude produced under far less stringent environmental controls.

I. Cap and Trade Generally

To reiterate our previously filed comments we are opposed to CARB continuing on the path of adoption of the cap and trade program. As noted previously, while CIPA began the climate change policy journey with a position that market mechanisms most efficiently provide for compliance flexibility, the evolution of our position has been influenced by two irrefutable factors.

First are the emissions numbers. The Legislative Analyst's Office has covered quite comprehensively, and we have previously detailed, that enough activity has been undertaken- numerous programs and policies put into place that coupled with dramatically reduced economic output have allowed us to achieve, or at least establish the glide path to the emission reduction targets envisioned by the framers of AB 32. Second, we look at the market design features of the currently proposed program and inherently understand that no matter how well intentioned they portend disaster for the economy as a whole and regulated entities specifically.

We note that a market based system is permissive and not mandated under AB 32. Health and Safety Code §38570 reads in part:

> 38570. (a) The state board ***<u>may</u>*** include in the regulations adopted pursuant to Section 38562 the use of market-based compliance mechanisms to comply with the regulations. (emphasis added)

CIPA asserts, again, that CARB has met all of the the emissions targets required by AB 32 and need only eliminate cap and trade from the current policy mix to arrive at a combined strategies alternative that satisfies AB 32 and does not set us up for a rerun of the terrible crisis the state experienced the last time it embarked upon an untested and ill-conceived Rube Goldberg policy regime.

Having registered our opposition to the instant cap and trade scheme we understand that CARB has no intention of abandoning this train wreck. Therefore, we note the following areas of major concern, but first, we would like to acknowledge a change staff did make in the most recent changes. The designation of crude oil as either light or heavy in the original draft was problematic for a number of reasons and we asked that a better designation be used and staff made the appropriate change to thermal/ non-thermal, which we appreciate.

II. “Ten Percent Haircut”

Rather than developing a “soft start” to the Cap and Trade program as previously approved by CARB, the 10% reduction (termed 10% haircut) poses potential problems for the availability of allowances at the onset of the program when uncertainty is expected to be greatest. At the very least, this will lead to severe inefficiency of the Cap and Trade Market, and likely will increase the already significant cost burdens to all industry sectors.

No documentation or information substantiating the need for the haircut has been presented. In reality, the reductions originally planned during the first compliance period now occur up front instead of staggered over a 3-5 year period. Also, the reduction in allowances has no relevant air quality benefit or emission reductions. It basically will generate hundreds of millions of dollars for no stated purpose and is a hidden tax on industry.

III. Benchmark

Other than the initial guidelines on how sector benchmarking would identify allowance allocation to various industries, CARB staff has not provided information on the individual protocols. For example, the proposed oil and gas extraction benchmarks (0.0816 for thermal and 0.0082 for non-thermal) are derived from a process that remains a “black box” to the regulated community. The generation of these benchmark values cannot be duplicated by the public sector.

The methods and protocols used by CARB staff should undergo the same scrutiny and verification that all of industry is required to follow for reporting emissions.

IV. Self-Generation Emissions

The unverified data CARB used to determine the oil & gas production benchmarks did not incorporate indirect GHG emissions, e.g., emissions associated with electricity and heat used/produced in the production process. For California oil & gas producers, the electricity and heat consumed in their operations can vary widely. For some facilities this represents a significant portion of energy used. Not considering this energy consumption in the calculated benchmarks is a gross error in ARB's approach and will skew the allocation with harmful economic repercussions. This error will have significant impact on how allowances are allocated. In fact, ARB currently is allocating no allowances to Cogeneration facilities in California and the indirect energy use for some of these facilities represents most of their GHG emissions. Coupled with the "haircut" noted above, there will be operators who fold because their margins will not support these increased costs and there is no opportunity to pass the costs along. This inequity must be corrected.

V. Facility

In the case of onshore petroleum and natural gas production, the reporting footprint is defined as the geological basin. Reporters would be required to determine and report emissions from stationary combustion, and specified process and vented emissions. The reporting entity may be either a facility or operator. But in all of the effort to harmonize, there is still confusion relative to current and ongoing reporting framework for local air districts. Oil and gas operators in California with multiple locations conceivably could be required to comply with air district, CARB, WCI and federal reporting requirements which will be confusing and costly especially given the enforcement penalties at CARB's disposal for such things as "inaccurate information".

CIPA supports the traditional air district facility definition. The basin definition is not only confusing, but the practical effect will be to bring smaller operators in to the mix who really weren't intended to be included in the large emitters category targeted for reporting, at likely prohibitive cost.